DIRECT TESTIMONY OF

KEVIN MARSH

ON BEHALF OF

SOUTH CAROLINA ELECTRIC & GAS COMPANY

DOCKET NO. 2004-178-E

Q. PLEASE STATE YOUR NAME, BUSINESS ADDRESS, AND POSITION.

A. My name is Kevin Marsh and my office is located at 1426 Main Street, Columbia, South Carolina. I am Senior Vice President and Chief Financial Officer of South Carolina Electric & Gas Company ("SCE&G") and hold a similar position at SCANA Corporation, which is the parent company of SCE&G.

Q. PLEASE DESCRIBE YOUR EDUCATION AND BUSINESS BACKGROUND.

A. I am a graduate, magna cum laude, of the University of Georgia, with a Bachelor of Business Administration Degree majoring in Accounting. I also hold a certificate as a Certified Public Accountant in the State of South Carolina and a member of the South Carolina Association of Certified Public Accountants. Prior to joining SCE&G in 1984, I was employed for seven years by the certified public accounting firm of Deloitte & Touche where I was designated an Audit Manager as a public utility accounting and audit specialist. I joined SCE&G in 1984 as the Group manager of Technical Accounting. In 1988, I was promoted to Controller and in 1989 was elected Vice President and Controller. In 1991, I became the Vice President of Corporate Planning. I later became Vice President and Chief Financial Officer of SCE&G and was promoted to my present position as Senior Vice President and Chief Financial Officer in 1998.

Q. WHAT ARE YOUR DUTIES WITH SCE&G?

A. As Senior Vice President and CFO of SCE&G, I have responsibility for monitoring the Company's present and prospective financial condition; for formulating strategies to ensure that the Company can meet its capital requirements at the lowest reasonable cost; and for managing all accounting and financial matters related to the Company. In that regard, I meet regularly with members of the financial community, including the Wall Street analysts and credit rating agency personnel who follow the electric utility industry in general and SCE&G specifically. In these meetings, we discuss their perceptions and concerns about the Company, its financial and business position, the markets and the utility industry generally. We also discuss the various risk factors that the Company faces as seen by investors. I am also regularly involved in discussions of investor perspectives on our company with underwriters and other experts as they pertain to the issuance or refinancing of debt and the issuance of new common stock. Such discussions have been a regular part of my job for the past eight years.

Q. HAVE YOU TESTIFIED BEFORE THIS COMMISSION IN THE PAST?

A. Yes. I have testified in a number of different proceedings, including proceedings a) to place in rates that last increment of the Company's investment in generation plant in service as part of the phase in plan following construction of the V.C. Summer Nuclear Station (1986), b) to site the Cope Generating Station (1991), and c) to the place in rates the Company's investment in the Urquhart Repowering Project (2002).

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A. The purpose of my testimony is to provide a financial overview of SCE&G's filing in this proceeding and the Company's financial situation as it relates to our decision to seek rate relief at this time. I will review SCE&G's financial and regulatory history and testify concerning the importance of balanced and consistent regulatory treatment to the financial health of regulated utility companies like SCE&G.

Q. PLEASE PROVIDE THE COMMISSION WITH A FINANCIAL OVERVIEW OF SCE&G'S RATE INCREASE REQUEST IN THIS PROCEEDING.

A. First, since our general rate proceeding in the fall of 2002 we have expended $229,814,763 to complete the new Jasper County Generating Station which was placed into commercial operation on May 1, 2004. The impact of the capital expenditures for the new Jasper County Plant and additional environmental and other equipment, increases in operating costs and depreciation expense, and other changes have reduced the Company's pro-forma return on common equity to 8.65% compared to the 12.45% authorized by the Commission in Order No. 2003-38. In my opinion, operating returns at this level will jeopardize the Company's financial condition and limit its access to the financial markets on reasonable terms. Therefore, the Company has asked for an increase in its retail electric rates of $81,192,000 on test year ended March 31, 2004.

This revenue increase is based on a return on common equity of 11.75% which I discuss in my testimony. Support for the Jasper County Plant costs, environmental expenditures, and other rate base and cost of service items are addressed in the direct testimony of Company witnesses Mr. Addison and Ms. Walker.

The Company also has included in its filing with the Commission a regulatory and accounting plan that, if approved, will eliminate the need to seek rate relief from its customers for the projected $287 million cost of the Federally mandated Saluda Dam Remediation Project. Company witness Mr. Addison will address the details of this plan in his direct testimony.

Q. WHAT IS THE STATUS OF THE ELECTRIC UTILTIY INDUSTRY TODAY?

A. As the Commission is aware, the electric utility industry, and the energy industry generally, went through a difficult period during the 1990's and early part of this decade. This was a time characterized by:

- Federally mandated deregulation of wholesale electricity markets;
- Calls for the rapid deregulation of retail electricity markets and deregulation that in fact occurred in some states;
- Consolidation and mergers that eliminated a number of smaller electric utilities and created several very large regional utilities;
- Sell-off of generation assets by some electric utilities in favor of reliance on merchant power;
- The growth of power marketing and merchant generation and then the collapse or near collapse of many of the companies that rushed into these markets (e.g. Enron, Dynegy, Allegheny Energy);
- Black outs, market manipulation and service problems in some areas where restructuring has taken place;
- Loss of investor confidence in the stock market in general, and in the energy sector specifically, as a result of accounting and other scandals.

Q. HOW DID SCE&G RESPOND TO THE CHALLENGES DURING

THIS PERIOD?

A. In response to the turbulence of the recent period, the Company has continued to pursue its strategy of remaining a South Carolina headquartered, integrated generation, transmission and distribution utility.

Q. WHAT HAS SCE&G DONE TO PURSUE THIS STRATEGY?

A. First, the Company has stuck to its core business and limited its risks through a careful and conservative approach to regulatory change. As I observed in my testimony in the 2002 rate proceeding:

> Financial markets have seen SCE&G as a company that operates in a healthy regulatory climate and has a reasonable risk profile. We have not built our business around off-shore investments, extensive power or gas trading activities, or highly leveraged merchant plant development. In fact, a recent report on the company by Merrill Lynch characterized our business strategy as “plain vanilla” and went on to say that was not at all bad in this market. We believe that these comments highlight the virtue of our consistent, conservative business strategy.

Q. DOES THE COMPANY’S STRATEGY PROVIDE COMPLETE PROTECTION FROM THE UNCERTAINTY AND TURMOIL IN THE ENERGY AND FINANCIAL MARKETS?

A. No. The Company is only one of the many energy companies that constitute the national energy industry. Accordingly, while the Company has followed a strategy of focusing on its core businesses and a conservative approach to regulatory change, we will continue to be affected by the overall market evaluation and perception of industry risks. This means we will always be impacted by investor and consumer confidence in the industry as a whole.

Q. DO THE REGULATORY DECISIONS OF THIS COMMISSION HAVE AN IMPACT ON INVESTOR CONFIDENCE?

A. Yes. Our business approach has been successful in part because it has matched this Commission's generally careful and conservative approach to regulatory change.

SCE&G has fared relatively well during recent periods of regulatory uncertainty and turmoil in the financial markets due in large part to investors' confidence that SCE&G would receive consistent, reasonable and balanced regulation from this Commission. This has allowed investors to continue providing capital to the Company at reasonable rates with confidence that their investments would be allowed the opportunity to earn a compensatory return.

Q. PLEASE ELABORATE ON THIS LAST POINT.

A. Utilities continue to be capital intensive operations. Maintaining reliable and efficient energy service to the people of South Carolina requires substantial capital investments. As CFO for SCE&G, one of my principal responsibilities is ensuring that the Company has access to capital on reasonable terms.

The capital requirements that SCE&G has faced in recent years related to its electric generation assets have been significant. The Company has made substantial investments in generating assets to meet the growing demand for electricity in South Carolina. Since I have been an officer of SCE&G, we have installed the Hagood internal combustion turbine, built the Cope Generating Station in Orangeburg County, repowered two formerly coal-fired units at Plant Urquhart with natural gas (and greatly expanded their output), and designed and constructed the new Jasper County Generating Station. We also have invested substantial amounts of capital in maintaining and upgrading existing plants, and in environmental upgrades. During the period since we started Cope construction, SCE&G has invested over $2.4 billion in its generation plants alone. As Company Witness Mr. Addison testifies, this $2.4 billion represents prudent and necessary investments in the generation assets that serve our customers.

But the fact remains that SCE&G has been able to provide reliable and efficient electrical service during this period only because it has been able to access substantial capital from national markets on reasonable terms. We must compete with hundreds of other companies to attract investors who are willing to invest their capital in SCE&G. The ability to access this capital has in turn depended on investors' confidence that regulators would allow a reasonable opportunity to earn a compensatory return on their investments.

As a relatively small company in the highly turbulent financial markets of the last few years, SCE&G was able to continue raising capital, and to continue investing in electric infrastructure in this State, because investors perceived South Carolina as having fair and reasonable regulation. That was a key factor for SCE&G in successfully weathering the recent turmoil in the industry.

Q. IN MAKING INVESTMENT DECISIONS, HOW DO INVESTORS EVALUATE THE RISKS SCE&G FACES?

A. The risk profile for SCE&G includes, among other things:

- The risk that new environmental regulations or more stringent limits of other discharges will impair the value of our coal generation plants;
- The risk that FERC or the Congress will impose poorly conceived market structures on our region that will damage SCE&G's ability to serve customers reliably and efficiently or will impair the value of our generation;
- The risk posed by volatile coal and natural gas markets;
- The nuclear risks associated with V.C. Summer Station (which is a risk that we share with all utilities that own nuclear plants); and
- The risk that, for whatever reason, SCE&G could lose the fair

and balanced regulatory environment that has historically justified investor confidence in the Company.

Q. HOW DO INVESTORS WEIGH THE IMPORTANCE OF THESE VARIOUS RISK FACTORS?

A. My experience has taught me that in evaluating the investment risk related to SCE&G, investors place as much weight on the Company's history of consistently fair regulation by this Commission as they place on any other single factor or group of factors. The reason that this one factor is so important is not hard to explain. Through rate cases and fuel clause proceedings, the Commission directly determines whether the Company will recover its cost of operations and whether investors will be allowed an opportunity to earn a reasonable return on the capital they provide. Almost all the other risks, if they happen, ultimately result in a proceeding before the Commission to determine how the impacts of those events will be reflected in rates and what effect they will have on investors' expectations of a fair return. In short, how the Commission exercises its statutory oversight is considered by investors to be both a risk factor in itself, and a factor in determining the seriousness of most other risk factors.

Q. HOW DO INVESTORS EVALUATE REGULATORY RISK SPECIFICALLY FOR SCE&G?

A. This Commission's reputation for consistently fair and balanced regulation is well established through orders issued in a variety of financial and economic conditions. SCE&G regularly reminds the investment community that this Commission provided responsible regulation a) when the Company's construction program (nuclear and fossil) was in jeopardy in the 1970s and 1980s due to runaway inflation and changes in Nuclear Regulatory Commission standards for nuclear construction; b) in the 1990s when the Company built Cope Generating Station at a time when the threat of retail deregulation had paralyzed other companies' construction programs and prevented them from building new base load plants; and c) two years ago when the Company was completing the Urquhart Repowering Project and incurring major expenses for the Jasper County Plant in an economy destabilized by the events surrounding 9/11 and the collapse of major players in the energy sector.

Q. HOW CLOSELY WILL INVESTORS MONITOR THIS PROCEEDING?

A. In practically every conversation I have had with credit rating agency personnel, investment analysts, and industry observers over the past several months, they have asked how we think that the new Commission members will approach regulation and how we think the new regulatory structure in South Carolina will work. The investment community understands that for a majority of Commissioners, this will be their first major gas or electric rate case, and that sitting Commissioners will serve for some time into the future. Therefore, investors are looking to this case to provide them a first indication of what regulation in South Carolina may look like for some time to come.

Q. WHY IS THE REACTION OF THE FINANCIAL COMMUNITY IMPORTANT TO THE CUSTOMERS OF SOUTH CAROLINA?

A. Our customers want reliable electric service. That encompasses not just our existing customers, but also new businesses considering relocating to or expanding into South Carolina. Reliable service does not come without costs and investments. The investment community plays a critical role in providing the capital investment needed to construct and maintain our generation, transmission, and distribution assets. To do so, investors need to feel they will be compensated fairly for the investment of their dollars in our Company.

In addition, fair returns to investors are critical to the financial health of the Company. Good financial health allows the Company to take advantage of favorable market conditions, which in turn lowers costs to customers. An example of this opportunity is outlined later in my testimony where the Company was able to access the debt capital markets to issue new long-term bonds and refinance some of its existing long-term debt resulting in interest expense savings for customers of $194 million. In short, the interests of the customers, investors, and the Commission are all tied together.

Q. HOW DO YOU BELIEVE INVESTORS VIEW THE PRESENT RATE FILING IN COMPARISON TO SCE&G'S OTHER RATE FILINGS?

A. Based on the conversations I have had with members of the investment community, most investors see this case as a continuation of the 2002 electric rate case, Docket No. 2002-223-E. In that case, SCE&G put before the Commission the capacity expansion –specifically the Urqhuart and Jasper projects-- that it was undertaking to meet growing demand. It also put before the Commission the extensive investments it was making in environmental projects. In the order in that case, the Commission allowed 100% of the Company's investment in the Jasper County Generating Station as incurred through December 31, 2002, to be reflected in rates through Construction Work in Progress or CWIP. This represented approximately half of the construction cost of project. The Commission also allowed the Company to reflect in rates for the first time the substantial environmental investments it had made since the previous electric rate case in 1995. The 2002 case was also the case in which the Company signaled its intention to find a way to defray the cost of the Saluda Dam Remediation project outside of rates. As a result, the investment community sees the present case as a follow-on case to Docket No. 2002-223-E and one in which the Commission has already heard testimony on most of the major issues.

Q. HOW DOES THE SALUDA DAM REMEDIATION PROJECT

FIGURE IN THIS RATE REQUEST?

A. What may be most unique about this case is what is not included in it. SCE&G is ***not*** seeking additional revenue to support the $287 million investment it is making in the Saluda Dam Remediation Project (the "Remediation Project"). Such revenues are not being sought because the Company has volunteered to use certain Synthetic Fuel Tax Credits earned through non-utility partnerships, along with other tax benefits, to defray the cost of the Project.

The Company is proposing that the Commission authorize it to use certain federal income tax credits related to synthetic fuel production along with tax benefits associated with depreciation of the Remediation Project, to offset the capital cost of the remediation work. Company witness Addison will explain the Company's proposed mechanism for using these tax benefits to offset the Remediation Project. My point is this: Of the several utilities and utility holding companies of which we are aware that are generating these credits, to date SCE&G is the only one to our knowledge that is using these credits to offset costs that would otherwise be passed on to customers.

Q. WHY IS SCE&G WILLING TO USE THESE TAX CREDITS TO OFFSET THE DAM REMEDIATION COSTS?

A. The Company believes that the rate relief requested in this case, when balanced with the voluntary use of these credits to reduce revenue requirements related to the Remediation Project, results in a favorable outcome for all parties. It is a clear signal of our Company's commitment to balancing the interests of customers with the needs of investors. By offsetting the capital cost of the Remediation Project, the proposal lowers the cost of electric service not just today, but for the entire useful life of the project. All parties can benefit from the proposal made here.

Q. IN YOUR TESTIMONY IN THE LAST RETAIL ELECTRIC RATE PROCEEDING YOU INDICATED THAT THE COMMISSION'S ORDER IN THAT CASE COULD HAVE IMPORTANT IMPLICATIONS FOR FUTURE DEBT ISSUANCES. COULD YOU REVIEW THAT TESTIMONY FOR US?

A. Certainly. In my testimony in Docket No. 2002-223-E, I testified that without reasonable rate relief, SCE&G faced the likelihood of an immediate downgrading of its debt ratings and resulting increases in the cost of raising additional capital. I explained that SCE&G's senior secured debt was then rated "A-" (A minus) by Standard and Poor's and "A-1" by Moody's.

I calculated that in the markets that existed at that time, a downgrade from single-A/A1 rating to a Baa1/BBB+ rating would add approximately $1.05 in financing costs for every $10.00 in capital raised over the life of a 30-year bond.

Q. WHAT IN FACT OCCURRED?

A. SCE&G was able to maintain its single-A rating in part based on the reasonable and balanced result in Docket No. 2002-223-E. Consequently, investors continued to support our capital requirements at favorable rates. Given that support and the reasonable debt financing costs available at the time, the Company moved quickly to borrow all the capital required to complete the Jasper County Plant and meet its other near term requirements. In 2003-2004, SCE&G (including its affiliate South Carolina Generating Company) issued $886 million in debt. Of that amount, $550 million was not tied to the refinancing of existing debt issues. Because of the order we received from this Commission and the credit ratings it supported, SCE&G's customers will save $41 million over the life of those financings based on the calculation I presented in Docket No. 2002-223-E.

Q. HAVE THERE BEEN OTHER BENEFITS FROM THE COMMISSION'S DECISION IN THE LAST CASE?

A. Yes, there have. Because the Company was successful in maintaining the Single A credit rating, we were able to take advantage of the historically low interest rates during this period. SCE&G has generated additional savings for its customers through the refinancing of existing debt issues with maturity dates of 2014 and 2023. As Mr. Addison testifies, in 2003 the Company refinanced $336 million of its outstanding debt during the period 2003-2004. These refinancings reduced interest cost of $7.3 million annually and total savings for our customers over the remaining terms of the redeemed securities of $153 million. Had our bond rating fallen below the single-A level, much of the resulting savings would have been lost to higher interest rates, if the refinancings could have been accomplished at all.

Q. WHAT CONCLUSIONS DO YOU DRAW FROM THESE FACTS?

A. The first point is, as I said in the 2002 testimony, that the Company, its customers and the Commission all share an interest in maintaining the financial health of SCE&G and its ability to raise capital on reasonable terms. If that ability is compromised, it becomes very difficult to maintain low-cost, efficient and reliable electric service to the people of South Carolina.

The second point is that it is often impossible to know in advance the opportunities that may arise for cost savings assuming that the Company has the financial standing to take advantage of them. We use the strength of SCE&G's balance sheet and standing in the markets to reduce capital costs whenever opportunities present themselves. In this case, the investors' confidence in the Company has allowed us to take full advantage of the favorable interest rates available in the markets in 2003 to reduce capital costs and costs to customers for 30 years.

Q. WHAT DOES THE FUTURE HOLD FOR SCE&G FINANCIALLY?

A. On a national or global scale, energy policy is becoming an increasingly important issue in the United States for reasons that include:

- The possibility of environmental limits on energy production;
- The volatility of coal, oil and natural gas markets in this country today;
- The political instability in the Middle East; and
- The increasing world demand for energy (particularly with China's emergence as a major energy consumer on the global market).

With completion of the Jasper County Generation Station, SCE&G will have built enough new generating capacity to meet load growth for the several years based on present forecasts. The Company will continue to invest capital in environmental upgrades, in refurbishment of existing plants, in extending and reinforcing our transmission and distribution systems, and in other capital needs for operating the system. We will continue to monitor conditions to determine when to refinance debt or to set additional debt or equity as needs and opportunities present themselves in the future.

While this is the Company's present financial plan, it depends on many factors beyond our control. Our current plan is based on the rating agencies not tightening the standards for single A rated companies. It also assumes that the market will continue to support our present dividend payout ratio, which reflects recent reductions in those rates. While we do not know precisely when we will go back into the capital markets, we do know that if the rating agencies were to change their standards for a single A rating, or if the market were to withdraw support for our current, quite low, dividend payout ratio, then we could be required to go to the market very quickly to raise substantial additional capital. In addition, unanticipated changes in environmental standards, or unanticipated requirements to invest in new energy technologies or in further improvements or refurbishing of existing plants could force us into the capital market in short order. In summary, there are a number of reasonably possible scenarios in which SCE&G would be back in the capital markets in the near term.

Q. IN YOUR OPINION, AND BASED ON YOUR EXPERIENCE WITH SCE&G AND THE CAPITAL MARKETS IN WHICH IT OPERATES, WHAT IS THE APPROPRIATE RATE OF RETURN ON EQUITY FOR SCE&G IN THIS PROCEEDING?

A. In my opinion, and based on my knowledge of the Company and my experience in the capital markets in which SCE&G operates, the appropriate return on equity on which the Commission should set rates in this case is 11.75%.

Q. WHY IS 11.75% THE APPROPRIATE RETURN ON EQUITY IN THIS CASE?

A. I base this conclusion on a number of factors. Specifically, I have reviewed the testimony and analysis of Dr. Malkiel concerning an appropriate ROE for SCE&G. I concur with his conclusion that market returns are at historically low levels and are likely to move higher, pushing return expectations higher for companies like SCE&G.

As to the proper ROE for setting rates, I agree with Dr. Malkiel's conclusion that the upper range of an ROE for the Company should be the ROE set by the Commission in 2002, which was 12.45%. An important question before this Commission in this case is where --within Dr. Malkiel's range of reasonable rates-- the specific ROE should be set for establishing rates for the Company.

In considering my recommendation, I have reviewed the electric ROE awards given by the Commission for this Company since the early 1990s. This 14 year period reflects a variety of market conditions and encompasses three individual retail electric rate orders. Those orders were all issued during a time characterized by the uncertainties of electric restructuring and changing market conditions for our industry.

The average ROE granted in the cases decided during that period was approximately 12% --11.98% to be exact. I believe that a 12% ROE is representative of the ROE required and expected for our Company over the long term. In light of the current low interest rate environment, analysts' expectations, and the other cost of capital testimony in this docket, I believe that a point in the upper half of Dr. Malkiel's range of reasonableness, or

11.75%, is an appropriate ROE on which to formulate rates in this case. This rate also reflects a 70 basis point reduction in the Company's currently allowed ROE of 12.45% which was set only two years ago. In today's financial markets, and with the likelihood of rising interest rates, the establishment of an ROE less than 11.75%, in my opinion, would risk sending a troubling signal to our investors.

As the courts have stated many times, the establishment of an ROE by this Commission is an exercise of judgment based on the facts presented and pragmatic considerations. Based on my judgment and experience, an ROE of 11.75% is a reasonable and pragmatic result reflecting the history of the markets and the atypical period we are in today.

Q. WHAT ACTION IS THE COMPANY REQUESTING WITH REFERENCE TO COMMISSION ORDER NO. 1999-655?

A. The Company is requesting the Commission to extend until December 31, 2010, the period over which it would be able to apply the accelerated capital recovery mechanism originally approved by the Commission in Docket No. 1999-389-E, Order No. 1999-655. This Order allows the Company in its discretion to accelerate depreciation of its Cope Generating Station when revenue or expense levels warrant. The mechanism would have expired on December 31, 2002, had it not been extended by the Commission in Order No. 2003-38 until December 31, 2005.

The mechanism created by Order No. 1999-655 continues to be a useful means of responding to periods when the Company experiences unusual levels of expenses or revenues. Under the mechanism, the Commission maintains at all times the ability to initiate a rate reduction proceeding if it believes that the Company's earnings will be higher than established levels on a sustained basis. The policy reasons that justified Order No. 1999-665 when issued continue to be valid and justify its extension. The Company respectfully requests that the Commission extend the applicability to the mechanism until December 31, 2010.

Q. DOES THIS CONCLUDE YOUR DIRECT TESTIMONY?

A. Yes, it does.